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IN THE
Supreme Court of the United States
OCTOBER TERM 1978
No. 78-1323

Norfolk and Western Railway Company,
Petitioner,

vs.

Kandythe J. Liepelt, Administratrix
of the Estate of Delroy Liepelt, Deceased,
Respondent.

On Writ of Certiorari to the Appellate Court of Illinois, First District, First Division

PETITIONER'S REPLY BRIEF

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PETITIONER'S REPLY BRIEF

INTRODUCTION

Respondent has not offered any arguments that justify either of the income tax-related rulings of the Illinois courts.

I. The Illinois Courts' Refusal To Allow Evidence Of The Taxes That Decedent Would Have Paid On His Estimated Earnings Violated The FELA.

The first question in this case pertains to the formula for determining the amount of damages to be awarded in actions under the FELA. The Illinois courts held—and respondent now contends—that a FELA wrongful death claimant has a federal right to recover, as part of his damages, the entire amount of the income taxes that the decedent would have paid out over his lifetime, and thus that a jury may *never* be allowed to exclude the amount of such income taxes from a

decedent's recovery, regardless of the degree to which income taxes would have been paid on his earnings. To dispose of the first question presented in this case, this Court need only decide whether this absolute prohibition of any consideration of income taxation can be squared with the fundamental principle that damages are to be compensatory only and with the established rule—which respondent has simply ignored—that all other personal expenditures be excluded from such awards.

A. Unless A Decedent's Income Taxes Are Excluded From The Wrongful Death Award, The Damages Will Exceed The Amount Of The Beneficiaries' Pecuniary Loss And Thus Be Inconsistent With The FELA.

Respondent has advanced a series of arguments to the effect that the FELA itself requires the adoption of the Illinois rule. However, these arguments are patently inconsistent with the statutory prescription that FELA wrongful death awards are to compensate the statutory beneficiaries "for the loss and the damage resulting to them financially by reason of [their decedent's death] ... and for that only." *Michigan Central R.R. Co.* v. Vreeland, 227 U.S. 59, 68–72 (1913).

1. "Gross Earnings" Is Not Now And Never Has Been The Measure Of Wrongful Death Damages.

Respondent's defense of the Illinois rule is premised on her repeated assertions that the decedent's estimated lost "gross" earnings must serve as the measure of FELA wrongful death awards. (*See, e.g.*, Respondent's Brief, at 9.) It is manifest, however, that "gross earnings" are not now and never have been the measure of these damages. Indeed, respondent's own presentation of her case to the jury was inconsistent with any such theory.

Because wrongful death awards under the FELA (and under all statutes modeled on Lord Campbell's Act, 9 and 10 Victoria c.93) are intended to compensate the decedent's statutory beneficiaries for *their* financial losses, the size of the award is determined by the value of the *contributions* the decedent would have made to his beneficiaries, not the amount of his *gross* earnings.[1] *See* H. F. Harper & F. James, The Law of Torts, §25.14 at 1329.

The corollary to the principle that the beneficiaries' lost receipts measure the wrongful death recovery is that the tribunal must exclude from the award all amounts that the decedent never would or could have contributed to his beneficiaries. Thus, courts have always been required to permit evidence of the decedent's personal expenditures and to instruct the jury to deduct them from the decedent's gross earnings in determining the amount of the beneficiaries' loss.[2] *See Kansas City Southern Ry.* v. *Leslie*, 238 U.S. 599, 604 (1915); F. Harper & F. James, *supra*, §25.14 at 1329; Illinois Pattern Jury Instructions, Civil §160.15 (2nd Ed. 1971). Indeed, this rule is so well established that not only did the instructions given in this case direct the jury to deduct the amount of the decedent's personal expenditures from his

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[1]That the whole focus of the assessment of wrongful death damages is upon the contributions the decedent would have made to his beneficiaries is illustrated most clearly by this Court's early holding that "the rule for the measurement of damages must differ according to the relation between the party plaintiff and the decedent." *Michigan Central R.R.* v. *Vreeland*, 227 U.S. 59, 72 (1913). This holding refutes any notion that claimants are entitled to some fixed amount of the decedent's lost earnings and confirms that the beneficiaries' lost receipts measure the recovery.

[2]Notably, because these amounts include sales taxes and other excise taxes, some of the taxes a decedent would have paid out over his lifetime are already being deducted from awards, even under the Illinois courts' approach.

estimated gross earnings in determining the amount of the award (A84), but respondent herself proposed that the instruction be given (A85). She made this request, moreover, because her own pecuniary loss evidence, presented through an expert witness, had excluded her decedent's personal expenses in calculating the amount of such loss (A55-A56).

The critical point is that income taxes are simply a specific kind of personal expenditures, being payments to satisfy a duty to government. Just as the statutory standard requires a deduction from gross earnings of other personal expenditures, so too it requires a deduction of the income taxes a decedent would have paid over his lifetime. *See Kansas City Southern Ry.* v. *Leslie, supra.* For the taxes a decedent would have paid on his gross earnings over his lifetime, like his other personal expenditures, all represent portions of his gross earnings which never could have been contributed to his statutory beneficiaries if the fatal accident had not occurred[3] and which must, accordingly, be excluded from any award.

2. The Exclusion Of Taxes From The Award Does Not Confer A Windfall On A Defendant

An argument that is closely related to respondent's repeated assertions that "gross earnings" should measure her award is that any other measure of recovery would confer a windfall on petitioner. She reasons that, if there had been no fatal accident, the railroad defendant would have been

[3]Respondent's argument that a railroad must always be required to pay out as damages the entire amount of the decedent's gross earnings is also flatly inconsistent with the fact that, under the FELA, a railroad will be liable in damages for the wrongful death of an employee *only if* he is survived by one of three classes of dependent relatives. 45 U.S.C. §51. The critical point is that Congress intended to redistribute losses, not punish railroads.

required to pay the decedent his gross earnings, and that gross earnings must measure the recovery or the defendant would profit from its wrong. (Respondent's Brief, at 9).

This argument simply ignores that the FELA prescribes that damages be measured by the statutory beneficiaries' pecuniary loss. The exclusion from the award of the income taxes the decedent would have paid would no more confer a windfall on the defendant than does the established practice of excluding the decedent's other personal expenditures from the award. Both are simply consequences of the Congressional decision that the FELA awards are to be measured by the amount of the beneficiaries' lost receipts.[4]

Respondent, in any case, is simply wrong in suggesting that a defendant will "profit from its wrong" if it were permitted to pay out in damages a sum that is less than the present value of the decedent's lost *gross* earnings. The point this argument overlooks is that, following the accident, petitioner will not only pay damages equal to the value of the beneficiaries' financial losses, but also will pay "someone else to perform the services" decedent performed before his death. *British Transport Comm'n* v. *Gourley*, [1956] A.C. 185, 3. All

[4]Indeed, it is *respondent's* position which would confer windfalls and produce the incongruous results. For example, the FELA authorizes a decedent's parents to sue for wrongful death if there is no surviving spouse or children. See 45 U.S.C. § 51. If respondent were correct that FELA death claimants have a federal right to recover, as part of their damages, the income taxes their decedents would have paid, it would mean that such parents will recover—in addition to the pecuniary loss they would suffer over *their* life expectancies—the present value of the income taxes the decedent would have paid over *his* (presumably much longer) life expectancy. Carried to its logical extreme, respondent's position would require holding that a statutory beneficiary who would not have received *anything* from the decedent will have a right to recover as his "damages" the present value of the income taxes his decedent would have paid over his lifetime.

E.R. 796, 809 (Lord Reid).[5] Whatever the measure of damages, petitioner will be worse off financially following the accident than before.[6]

3. Public Policy Considerations Do Not Support The Illinois Courts' Holding

Respondent hints in her brief that considerations of public policy and developments in the law of torts require awarding, as part of a wrongful death claimant's damages, the entire amount of income taxes his decedent would have paid out over his lifetime. All such considerations, however, compel the exclusion of such taxes from the awards and the continued adherence to a pecuniary loss measure of damages.

In support of her public policy arguments, respondent quotes at length from *Kernan* v. *American Dredging Co.*, 355

[5]The decedent's replacement, moreover, will pay income taxes to the government on those wages, so the U.S. Treasury will not suffer a revenue loss as a result of any such death. Thus, respondent's suggestion to the contrary notwithstanding (Respondent's Brief, at 10), it is not surprising that the Internal Revenue Code has no provision for the collection of the taxes the decedent would have paid on his earnings, and the absence of such a provision is assuredly not a reason to adopt the Illinois rule.

[6]Nor is there any merit to the related argument that the income taxes a decedent would have paid on his earnings would be a "collateral issue" in a death case because taxes are a matter between the taxpayer and the government. (Respondent's Brief, at 7.) This argument too simply misses the point. The decedent's projected personal expenditures on, for example, food, clothing, and shelter, are excluded from death awards, even though the price paid for such goods is a matter between the purchaser and the merchant. There is no justification for treating a decedent's income taxes any differently. This consideration, moreover, disposes of any argument based on any so-called "collateral source" rule.

U.S. 426, 431–432 (1958) (Respondent's Brief, at 6). There, this Court, in construing the Jones Act, noted that the FELA had been interpreted as favoring compensation and that the concept of fault had thus been diluted so as to ease recovery for losses occasioned by operations of railroads.[7] However, the liberalization of the rules governing a railroad's *liability* to its employees provides no support for the liberalization of the measure of damages. On the contrary, quite apart from the fact the FELA is intended to redistribute losses, not punish railroads, the constant expansion of the conditions under which railroads are held liable for industrial accidents has given the FELA elements of a system of social insurance and has made it all the more essential that damages continue to be limited to the value of the beneficiaries' pecuniary loss. Liability determinations having been divorced from considerations of blameworthiness, there can be no justification for requiring a railroad to pay out in damages any amount in excess of the loss suffered as a result of the employee's death. *See* II F. Harper & F. James, The Law of Torts, § 25.22, at 1346.

Of course, the critical consideration is that the FELA has clearly prescribed a pecuniary loss standard. As this Court recently stated in a similar context, "we need not pause to evaluate . . . policy arguments. Congress has struck the balance for us. It has limited survivors to recovery of their pecuniary losses." *Mobil Oil Corp.* v. *Higginbotham*, 436 U.S. 618, 623 (1978) (holding that damages for "loss of society"

[7]*See generally* Alderman, What The Supreme Court Has Done To The Old Law of Negligence, 18 Law & Contemp. Prob. 110 (1953); *Brown* v. *Western Ry.*, 338 U.S. 294 (1949) (presence of clinker of coal in railroad yard is actionable negligence).

are to be excluded from recoveries under the Death On The High Seas Act).[8]

B. There Is No Justification For Treating Income Taxation Differently From Other Personal Expenditures.

In light of the patent inconsistency between the ruling below and the statutory requirement that all the decedent's other personal expenditures be excluded from the award, it is not surprising that the briefs filed in support of the Illinois courts' rulings have been primarily devoted to advancing arguments which, if valid, might justify treating the amount of a decedent's income tax liability differently from his other personal expenditures. None of these arguments, however, will withstand analysis.

1. There Is Nothing In §104(a) Of The Internal Revenue Code That Modifies The Damages Principles Established By The FELA.

The principal argument that has been advanced in defense of the Illinois courts' holding is that §104(a) of the Internal Revenue Code[9], which provides that personal injury awards

[8]This decision severely limited the Court's earlier holding in *Sea-Land Services, Inc.* v. *Gaudet*, 414 U.S. 573 (1974), relied upon by respondent (Respondent's Brief at 14 n. 6). It bears noting, moreover, that while departure from the statutory standard in *Mobil Oil Corp.* v. *Higginbotham* could have advanced the objectives of the general maritime law and promoted uniformity, *see* 436 U.S. at 626–630 (Marshall, J., dissenting), no comparable argument could be made in this case. The FELA is the exclusive authority for the measure of damages in actions falling within its provisions. *See, e.g., North Carolina R.R. Co.* v. *Zachary*, 232 U.S. 248 (1914); Petitioner's Brief at 15–19.

[9]Although a portion of this statute was quoted in Petitioner's Brief at 2-3, it is apparent, in light of the arguments made in Respondent's Brief, that the whole statute is relevant, and it is set out in its entirety in the Appendix to this reply brief, *infra*, at p. 27.

are not subject to income taxation, also prohibits excluding from wrongful death awards the amount of income taxes the decedent would have paid over his lifetime. Respondent contends—in arguments scattered throughout her brief—that §104(a) confers a federal right upon all wrongful death claimants (and indeed upon all personal injury and sickness claimants) to recover—in addition to the amount to which the claimant is entitled under the statutory tort standard—the entire amount of the income taxes that would have been paid on any lost earnings. The claim, in short, is that §104(a) impliedly repeals the statutory standards for determining the amount of a wrongful death claimant's recovery. This argument seriously misconceives the operation and effect of §104(a), for it confuses the question of the measure of damages with that of the taxability of the award. Acceptance of respondent's interpretation of §104(a), moreover, would not only affect the measure of FELA damages but would fundamentally alter *all* forms of personal injury compensation in this country.

There is nothing in §104(a)'s terms or history which even begins to suggest that it could prescribe how a personal injury award is measured. The statute provides only that certain cash receipts are not to be included in a taxpayer's adjusted gross income: *i.e.*, "the amounts received under workmen's compensation acts as compensation for personal injuries or sickness," §104(a)(1); "the amounts of any damages received (whether by suit or agreement) on account of personal injury or sickness," §104(a)(2); and the amounts received for personal injury or sickness "through accident or health insurance" as a "pension, annuity, or similar allowance." §104(a)(3) & (4). The statute, quite plainly, cannot be read as dictating the formula to be used in calculating the *amount* of any of these receipts. It merely says that after

the size of the award has been determined under the applicable standards, the award itself will not be subject to a tax. Section 104(a) thus supports the continued application of the statutory standards for measuring FELA wrongful death awards. The legislative history of 104(a) is entirely clear on this point.[10]

The fallacy of respondent's basic argument is illustrated by her contention that the acceptance of petitioner's

[10]The genesis of §104(a) may be summarized briefly. Shortly after the Internal Revenue Code became effective in 1913, the Treasury Department issued a ruling that any amounts received as compensation for a personal injury were to be treated as income to the recipient and taxable as such. U.S. Treas. Reg. 33 (rev.), Art. 4, §25 (1918). Under this ruling, the entire amount of any personal injury award was taxable to the recipient in the tax year received.

The ruling, however, proved to be extremely short-lived. In response to this Court's decision in *Doyle* v. *Mitchell Brothers Co.*, 247 U.S. 179 (1918), the Attorney General and the Treasury both issued subsequent interpretive rulings that held that amounts realized as a result of personal injuries "merely take the place of capital in human ability which was destroyed by the accident, [and t]hey are therefore 'capital' as distinguished from 'income' receipts" and are exempt from taxation. 31 Ops. Atty. Gen. 304, 308 (1918); *accord*, Treasury Decision 2747, 20 Treas. Dec. Int. Rev. 475 (1918). The predecessor to §104(a) was enacted later in 1918. Revenue Act of 1918, §213(b)(6), 40 Stat. 1066. Its legislative history states that it was adopted because "under the present law it is doubtful whether amounts received . . . as compensation for personal injuries or sickness and damages received on account of such injury or sickness are required to be included in gross income," H.R. Rep. No. 767, 65th Cong., 2d Sess. 9–10 (1918), thus reflecting the existing view that such damages could not constitutionally be taxed. Although §104(a) has been reenacted several times, Congress has never attempted any further explanation for its inclusion in the Internal Revenue Code. Thus, contrary to the respondent's contention that §104(a) was enacted out of a "humanitarian concern" to increase the size of damages awards, it is quite clear that Congress' sole objective has always been only to make the various awards—however they are computed and whatever their amount—tax free.

interpretation of §104(a) would fundamentally alter all forms of injury compensation in this country, including "[w]orkmen's compensation benefits, social security disability awards, insurance disability awards and medical and life insurance payments." Respondent's Brief, at 22–23. This argument is simply wrong.[11] The amounts received pursuant to these awards are made exempt from taxation by §104(a), and they will continue to be exempt from taxation whether or not this Court agrees with petitioner as to how FELA damages should be measured.[12]

[11]Moreover, if *respondent's* interpretation of §104(a) were correct, it would mean that *all* personal injury and sickness claimants *must* receive, as part of their awards, the amount of taxes that would have been paid on lost earnings. Such a holding would alter all forms of compensation in this country in which the claimant's recovery is not based on the entire amount of lost *gross* earning.

[12]Even if respondent's argument concerning the meaning of §104(a) were valid, it would still have no applicability to this case, for this statutory provision neither applies to wrongful death awards nor could affect their taxability.

By its terms §104(a) applies only to amounts received by reason of "personal injury or sickness," and this language excludes death awards. Accordingly, the Internal Revenue Service has twice held that although death awards are tax exempt, the reason is that they are not income within the meaning of §61 of the Code, not that §104(a) exempts them from tax. *See* Rev. Rul. 54-19, 1954-1 Cum. Bull. 179 (holding, respondent's misstatement to the contrary notwithstanding (Respondent's Brief, at p. 8 n.2), that a death award does not "constitute taxable income to the dependents who received the proceeds"); VII-27-3788, I.T. 2420, VII-2 Cum. Bull. 123 (1928) (same); 26 U.S.C. §61. That the Internal Revenue Service is correct that a death award could never be included in "gross income" is clear from the principles that determine the taxation of judgments generally, for an award based on the *contributions* the decedent would have made to his dependent relatives if the fatal accident had not occurred is not a substitute for any "income" that the death claimant would have "realized." See *Hort* v. *Commissioner*, 313 U.S. 28, 31 (1941).

2. Consideration Of Income Taxation Presents No Greater Difficulties And Involves No More Speculation Than Do Any Other Elements Of The Award.

Respondent urges that determination of a decedent's future tax liability is so speculative and complicated that taxation should never be taken into account in computing FELA damages—no matter how great the extent to which plaintiff will be overcompensated. Respondent's Brief, at 16–20. However, no serious argument has been made that determinations concerning taxation are any more speculative or any more complicated than are other components of damages calculations.

a. Alleged Speculativeness.

The speculation argument asserts that, because there may be future changes in the tax laws, it is impossible to say with complete certainty what the effective rate of taxation would have been on a decedent's *future* earnings.[13] But it simply ignores that there is far more speculation inherent in determining what those future earnings would be (and in determining the other elements of the award) than there is in determining the effect taxation would have on the future earnings.

The major elements in determining the lost future earnings are life expectancy and future earning power. But insofar as these determinations are made with respect to any

[13]Respondent apparently concedes that there is no problem whatever in determining taxes on the decedent's lost *past* earnings—*i.e.*, those occurring between the date of the trial and the fatal accident—and that the speculativeness-complexity arguments are completely inapplicable with respect to those earnings. *See, e.g., Varlack* v. *SWC Caribbean, Inc.*, 550 F.2d 171, 177–178 (3d Cir. 1977). Because the Illinois courts excluded evidence of past as well as future taxes, a reversal would thus be required in this case. *See* Petitioner's Brief at 25 n.18.

particular decedent, they are the sheerest conjecture. The length of time any single individual will live and his earning power while alive are determined by such a multiplicity of factors—including the future actions of third parties—that the only thing which is certain about the predictions made pertaining to any single individual is that they nearly always will be erroneous and that they often will be very, very wrong.[14] But notwithstanding the speculativeness of these factors, our system of single lump sum awards requires that tribunals exercise their best judgments concerning these elements because they are of obvious relevance to the value of the loss suffered.

Against this background, no claim can be made that the future effect of income taxation is too conjectural ever to be considered in the process. Once the amount of a decedent's future earnings is determined, a tribunal would be able to determine, with at least as much accuracy as its other determinations, the extent to which future income taxation would have reduced the decedent's disposable income. "Nothing can be more certain than that there will be a federal income tax in the years to come and that it will be substantially what it is now and what it has been for many years." *McWeeney* v. *New York, N.H. & H. R.R. Co.*, 282 F.2d 34, 42 (2nd Cir. 1960) (Lumbard, J., dissenting).[15]

[14]This is even more true with respect to the other recognized elements of a death award. For example, here the jury was permitted to award damages for "lost guidance" to decedent's children even when respondent's own expert testified that there was no basis for assigning a value to this loss. See A59–A60.

[15]In an attempt to avoid this obvious conclusion, respondent lists (Respondent's Brief at 17–18) a number of changes in the Internal Revenue Code that have occurred since 1947, *e.g.*, increasing the amount of the standard deduction and personal exemptions, tinkering with the rates, and adding personal deductions which only a

(footnote continued on following page)

b. Alleged Complexity.

In urging that taxation is too complex a consideration for jurors, respondent—quoting the discredited interpretation of New Jersey law of *Huddell* v. *Levin*, 395 F. Supp. 64, 91 (D. N.J. 1975)[16] (Respondent's Brief, at 16–17)—lists a parade of tax issues that would "predictably" arise if taxation were taken into account in FELA cases, including, to list but two, the "availability of professional corporation status" and "the amount and period of withholding income from taxation under retirement plans." The suggestion that railroad employees would routinely present these tax problems is wholly unrealistic. Experience, moreover, teaches that the

(footnote continued from preceding page)

small percentage of taxpayers are able to claim. This list proves petitioner's basic point, for the changes that are referred to are exceedingly minor ones to have been made over a period of thirty years.

But the critical point is that the minor changes Congress has made over the years have not materially affected the *effective rate* of taxation. A recent Brookings Institution Study concerning federal income taxation from 1960 to 1975 concluded that, although Congress, during the years in question, repeatedly amended personal income tax laws, the effect of its actions was to take account of the "increased taxes caused by inflation" and that "[a]s a result of these changes in tax laws, effective tax rates have increased very little since 1960." The Brookings Institution, Inflation and the Income Tax, p. 153 (Aaron, ed., 1976). Of course, when there are increases in "real income"—as railroad employees have experienced—there will be corresponding increases in the effective rate of taxation. This consideration makes it all the more important that the effects of income taxation be reflected in the determination of the amount of FELA statutory beneficiaries' pecuniary losses.

[16]The *Huddell* v. *Levin* court erroneously anticipated that the New Jersey Supreme Court would hold that evidence of the decedent's tax liability may never be considered in wrongful death actions. Later that very year, however, the New Jersey Supreme Court held that the decedent's income tax liability is to be excluded from *all* wrongful death awards, *Tenore* v. *NU Car Carriers, Inc.*, 67 N.J. 466, 341 A.2d 613 (1975), so the District Court in *Huddell* v. *Levin* was reversed. 537 F.2d 726 (3rd Cir. 1976).

question of future tax liability would almost certainly be resolved on the basis of the same sort of estimates which are used to determine all other major components of the beneficiaries' loss.

The other major factors of damages awards—life expectancy, future earnings, personal expenditures, household services, and rate of return—could all be broken down into the same sort of endless array of complex subsidiary issues as can taxation. As to life expectancy, for example, one could hypothesize that there could be days of confusing expert testimony concerning the decedent's health and habits, including evidence concerning each major organ in the decedent's body and the likelihood of its having "prematurely failed". As a practical matter, however, life expectancy issues—notwithstanding their critical effect on the amount of any award—are normally resolved on the basis of standard tables. Indeed, that proof of major elements in damages computations does not degenerate into extended battles of experts over subsidiary issues is illustrated by the trial of this very case.[17]

The reason that rough estimates generally suffice—as they did here—is not that they are accepted as finely calibrated, precise measures of the elements of a claimant's loss. On the contrary, it is because notwithstanding the tendency "to talk

[17]Here, the testimony of one expert presented by respondent sufficed to show that decedent would have lived for 34 years if there had been no accident, that his wages would have been $16,800 at the date of the trial and would have increased at a rate of 5% per year, that the value of his household services would have been equal to 9% of decedent's annual gross income, that the decedent's personal expenditures would have been 10% of his gross income for one period of his life, 25% for a later period, and 50% of gross income for a still later period. (A46–A61).

It strains credulity to suggest that it would have precipitated a lengthy battle of tax experts if this same expert had gone on to testify that decedent would have paid out, *e.g.*, between 12% and 15% of his gross income in income taxes over his lifetime.

glibly of the jury's complex computations . . . we know full well that the give and take of the jury room is in round figures and does not deal in actuarial tables, decimal points, and percentages." *McWeeney* v. *N.Y., N.H. & H. R.R. Co.*, 282 F.2d 34, 42 (2nd Cir. 1960) (Lumbard, J., dissenting). That taxation is amenable to this same treatment is established by the existence of tables, referred to in respondent's brief (Respondent's Brief, at 13), indicating the percentage of gross earnings that are paid in income taxes each year by wage earners at the different income levels.[18]

But all these arguments aside, *Chesapeake & Ohio R. Co.* v. *Kelly*, 241 U.S. 485 (1916), disposes of the argument that income taxation is too difficult to be taken into account in FELA cases. There, this Court held that the FELA requires that wrongful death awards be discounted to their present value—notwithstanding that performing that calculation involved "difficult mathematical computations for the ordinary juryman" and were, in the Kentucky Court of Appeals' view, "more than ought to be asked of anyone less qualified than an actuary" (241 U.S. at 489). The reason this Court held that such difficult computations had to be made is that failure to do so would have invariably overcompensated

[18]See Internal Revenue Service, Preliminary Statistics of Income 1976, Individual Income Tax Returns (4–78), p. 14. These tables show that heads of households like decedent with estimated earnings of $16,800 for 1977—the date of the trial—would, under this table, pay, on the average, approximately 12% of his earnings to the federal government in income taxes. Under these tables, the average percentage of income taxes paid for the various categories of operating railroad employees who are heads of households would, for that year, have ranged from approximately 12% for individuals at the low end of the scale (*i.e.*, incomes of a little over $16,000, *see* National Railway Labor Conference, Wage Statistics, Annual 1977, Operating Employees, p. 4 (1978)) to approximately 15% for individuals at the upper end of the scale (*i.e.*, average incomes of $29,154.04, *see ibid.*).

many FELA claimants. This principle is dispositive here. First, the amount of a decedent's income taxes will frequently be a far more significant determinant of the amount of the beneficiaries' loss than will be other recognized elements of FELA death awards—*e.g.*, the amount of the personal expenditure deduction,[19] the value of the household services he would have supplied,[20] and even the discount rate on the award.[21] Second, jurors have had personal experience in computing taxes, and will, with the aid of such expert testimony as may be supplied, find that a far more manageable task than the entirely alien one of determining the present value of future losses.[22]

3. That An FELA Plaintiff's Attorneys' Fees Are Not Included In Recoverable Damages Is No Justification For The Illinois Courts' Holding.

Ignoring income taxation cannot be justified on the theory that it is an offset to plaintiff's attorneys' fees. Not only is respondent's contrary claim flatly inconsistent with

[19]Here, for example, decedent's personal expenditures for a major period of his life were estimated at 10% of his annual gross earnings, a figure which is appreciably less than railroad laborers' average tax liabilities. *See* n. 18, *supra*.

[20]Decedent's household services were here valued at 9% of his gross earnings, which is much less than railroad laborers' average tax liabilities. *See* n. 18, *supra*.

[21]There are cases in which consideration of income taxation would have a far more significant effect on the size of an award than would reducing it to its present value: *i.e.*, cases in which the trial occurs within a few years of the decedent's projected retirement date.

[22]The suggestion implicit in respondent's argument—that juries are not competent to decide such income tax questions—is also contrary to the whole body of the jurisprudence of the FELA. This Court has stated repeatedly that, regardless of the complexity of the questions, juries must, in FELA cases, be presumed to "fair[ly] perform[ ] their constitutional functions." *Wilkerson* v. *McCarthy*, 336 U.S. 53, 62 (1948) (Black, J.).

the American rule prohibiting a prevailing party from recovering his attorneys' fees, either directly or indirectly, *see Alyeska Pipeline Co.* v. *Wilderness Society*, 421 U.S. 240 (1975),[23] but it ignores that it would be nothing short of irrational to treat the income taxes that the decedent would have paid over his lifetime as a "proxy" for the fees that his beneficiaries will pay to their lawyer. There simply is no correlation whatever between the two amounts. One can no more defend the practice of including taxes in an award on the theory it offsets attorney fees than one could have invoked such notion to defend allowing FELA death claimants to recover their decedent's personal expenditures or allowing a Death On The High Seas Act claimant to recover for "loss of society." *See Mobil Oil Corp.* v. *Higginbotham*, 436 U.S. 618 (1978).

4. The Possibility That An Adjustment Might Be Made For The Taxation Of Interest Earned On An Award Is No Justification For The Illinois Courts' Holding.

Respondent's final argument in defense of the Illinois courts' rule—which is based entirely on a misreading of language from *McWeeney* v. *New York, N.H. & H. R.R. Co.*, 282 F.2d 34, 37 (2nd Cir. 1960)—is that the exclusion from an award of the decedent's income taxes never could have a material effect on the size of an award and that these taxes may be disregarded without causing any injustice. The contention proceeds from the premise that if the income taxes the *decedent* would have paid on his *earnings* if there had been no accident were excluded from the award, it would necessarily follow that the jury must further be required to increase the

[23]The FELA Plaintiff's Bar appears to be of the view that the American rule prohibiting any recovery for attorneys' fees should be inapplicable in FELA cases. If so, they should raise the point directly and litigate it, not rely upon it in support of the inclusion in the award of amounts that cannot be justified on any theory.

damages by the amount of tax the *beneficiaries* would pay on the *interest* the *award* would earn. Respondent appears to be arguing that this "taxation of interest" adjustment would invariably offset—or largely offset—the amount initially excluded from the award. There are several basic flaws with respondent's contention.

First, respondent's contention was rejected by the very court upon which respondent relies. Although the Second Circuit held in *McWeeney* that—for a number of reasons, including the difficulties of making this adjustment—it would not require that taxes be excluded from an award in a case in which the annual lost gross earnings figure was $4,800, it stated, contrary to respondent's argument, that it would require the exclusion of a decedent's income taxes in cases in which the lost annual earnings were appreciably higher. 280 F.2d, at 38–39. Thus, in *LeRoy* v. *Sabena Belgian World Airlines*, 344 F.2d 266, 276 (2nd Cir. 1965), that court required the exclusion of income taxes from an award when the projected lost future earnings had been in the range of $16,000 to $25,000—a decision which, if followed by this Court, would control the case at bar. Plainly, the Second Circuit has rejected the position that the possibility of a "taxation of interest" adjustment to the award is a sufficient reason to hold income taxation irrelevant in all cases.

But a far more basic problem with respondent's argument is the premise that measuring damages by lost contributions (and thus excluding decedent's income taxes from the award) would make it necessary for a jury to increase the award by the amount of taxes that would be paid on any interest the damages would earn. There is simply no relationship between the two issues. The argument that the award should reflect that income tax is payable on interest could be made whether or not this Court agrees with petitioner in this case,

and the outcome of this case would not make the argument any more or less persuasive. For example, even if gross earnings (not lost contributions) were the measure of FELA wrongful death awards, an FELA claimant could argue that the damages must reflect that the interest earned on the award is taxable because, otherwise, the annual yield of the interest plus the principal would be less than the decedent's annual gross earnings. Similarly, the identical argument could be made if the statutory measure of damages were ⅔ of gross earnings or a flat $5,000 for each year of the decedent's life expectancy. All respondent has raised is the basic issue whether the formula for discounting an award to its present value should take into account the fact that interest is taxable. This issue is entirely separate and distinct from the question of how a beneficiary's loss for any particular future year is to be measured.[24]

C. The Judgment Of The Illinois Appellate Court Is Not Supported By An Independent Adequate State Procedural Ground.

Respondent belatedly argues that the issue of the validity of the Illinois ruling under federal law has not been properly preserved for review in this Court because petitioner's offer of proof concerning the testimony of Mr. Barnes was insufficient under Illinois law. The short answer to this contention is that the Illinois Appellate Court in fact decided whether the trial courts' exclusion of all evidence of income

[24]Moreover, respondent, in any case, is simply wrong that the amount of taxes that would be paid on the interest earned by a death award over its amortization period would invariably offset entirely—or even offset largely—the amount excluded from the award by reason of taxes the decedent would have paid over his lifetime. There is no correlation between the two amounts. Indeed, in many cases, *no* taxes would be paid on the interest earned by the award: *e.g.*, if the beneficiaries were minors with no other income.

taxation had violated the FELA. This ruling eliminates any basis for arguing that petitioner's federal claim was not properly preserved in the trial court, for "there can be no question as to the proper presentation of a federal claim when the highest state court passes on it." *Raley* v. *Ohio*, 360 U.S. 423, 436 (1959); *accord*, *Jenkins* v. *Georgia*, 418 U.S. 153, 157 (1974); see generally R. Stern & E. Gressman, Supreme Court Practice ¶3.28, at 222–24 (5th Ed. 1978).

In any case, respondent's arguments that petitioner failed to preserve its federal claim lack all substance. First, the offer of proof was plainly adequate under Illinois law, for it served its function of permitting the "reviewing court [to] know what was exclude[d] and determine whether the exclusion was proper." *Hession* v. *Liberty Asphalt Products, Inc.* v. *Dept. of Revenue*, 93 Ill. App. 2d 65, 71, 235 N.E.2d 17(1968). Not only did it set forth all the relevant information to which Mr. Barnes would have testified on direct examination, but it was also more specific than was the testimony of respondent's expert Dr. Friedman as to other elements of pecuniary loss.[25]

[25]To the extent respondent is now arguing that the trial court should have rejected the offer of proof on the ground Barnes' name had not appeared on a pretrial list of witnesses, the claim is utterly frivolous. First, respondent plainly has waived any such claim because she did not raise it in the Illinois Appellate Court. But, in any case, her contention is contradicted by the plain terms of Ill. Rev. Stat. 1977 ch. 110A, ¶219(c)(iv) which provide that the remedy of excluding a witness's testimony is committed to the discretion of the trial judge and may not, in any event, be invoked unless the party "unreasonably refused" to include the witness's name in its initial list. The colloquy in the trial court shows, beyond any question, both that the trial judge here declined to exclude the offer of proof and that the omission of Barnes from the list had been entirely understandable under the circumstances. (A77–A79).

But the most fundamental defect in respondent's argument is that she assumes, contrary to all authority, that petitioner had to make a formal offer of proof to preserve its claim that it violates the FELA for a tribunal to refuse, in computing damages, to take into account the fact that a decedent with projected earnings of $16,800 to $51,600 (*see* Petitioner's Brief, at 3-4) would have paid income taxes on those earnings if there had been no fatal accident. Any such contention is contrary to the rationale of the decisions, cited in Petitioner's Brief at 32–33, which would be dispositive if followed by this Court.[26] Petitioner raised its claim at trial in a variety of ways, including attempting to cross examine respondent's expert as to the impact of taxation on the award (A61–A63),[27] and attempting to obtain a declaration that income taxation would be held relevant to the pecuniary loss determination. (A63–A75) These other steps were plainly

[26]Respondent's statement to the contrary notwithstanding (Respondent's Brief, at 21), several courts have held that the income taxes a decedent would have paid over his lifetime must be taken into account in *all* wrongful death actions. *E.g.*, *Tenore* v. *NU Car Carrier, Inc.*, 67 N.J. 466, 341 A.2d 613, 628 (1975); *Adams* v. *Deur*, 173 N.W. 2d 100, 105 (Iowa 1969); *see Burlington Northern, Inc.* v. *Boxberger*, 529 F.2d 284, 294 (9th Cir. 1975). Others have held that whether inquiry into taxation will be required depends upon the amount of the decedent's projected future earnings, and there is no question that decedent's projected future earnings of $16,800 to $51,600 fall within the range in which income taxation must be taken into account under this latter approach. *See, e.g., Burlington Northern, Inc.* v. *Boxberger*, 529 F.2d 284 (9th Cir. 1975) (projected future annual earnings of $18,048 to $40,000); *Sanchez* v. *Denver & Rio Grande W. R.R.*, 538 F.2d 304 (10th Cir. 1976) (annual earnings at death of $8,300); *Cox* v. *Northwest Airlines, Inc.*, 379 F.2d 893 (7th Cir. 1967) ($15,655 to $20,608).

[27]It is clear from the subsequent colloquy that, if cross examination regarding taxation had been permitted, petitioner would have questioned Dr. Friedman concerning the extent to which decedent would have paid income taxes on his earnings (A63–A75).

sufficient to preserve petitioner's claim. *See Burlington Northern, Inc.* v. *Boxberger*, 529 F.2d 284 (9th Cir. 1975) (no offer of proof made); *Tenore* v. *NU Car Carriers, Inc.*, 67 N. J. 466, 341 A.2d 613 (1975) (defendant may show effect of taxation by cross examining plaintiff's expert).

II. The Illinois Rule That A Trial Court May Never Inform A Jury That A Damages Award Is Not Taxable Caused A Separate And Independent Violation of Petitioner's Rights Under The FELA.

Under Illinois law, it is never permissible for a trial judge to give an instruction that, because the amount awarded to the plaintiff by the jury's verdict is not taxable to the plaintiff under the federal tax laws, the jury should not add any sum of money to the amount of the verdict on account of federal income taxes. *Hall* v. *Chicago & North Western R. Co.*, 5 Ill.2d 135, 125 N.E.2d 77, 86 (1955). Under this Illinois rule, it would be reversible error to give such an instruction even if it were certain that the jury would otherwise inflate the damages award by the amount of taxes that would have been paid on it if the award were not tax-free. Notwithstanding that one can scarcely imagine a more flagrant violation of the principle that FELA damages must be limited to the amount of a beneficiary's loss, respondent defends this Illinois rule. The arguments she makes all ignore what the proposed instruction says and misconceive its effect.

A. The Illinois Rule Is Unsupportable.

First, respondent's arguments that the giving of the proposed instruction could somehow prejudice the FELA claimant's interests are untenable. The contention that giving the instruction might cause jurors to *reduce* the award by the amount of an imagined tax (Respondent's Brief, at 30) is preposterous; what the proposed instruction says is that

income taxes should not be *considered* because the awards are not subject to income tax (A87).[28]

Second, respondent's contrary assertions notwithstanding (Respondent's Brief, at 30), petitioner's objection to the Illinois rule is not based on any assumption that jurors "automatically disregard the court's instructions." The reason the Illinois rule is so pernicious is that, unless the proposed nontaxability instruction is given, it would result in an award that substantially overcompensates the plaintiff if (1) the jury interpreted the court's charge as requiring it to include in the award any taxes that will be imposed on it, and (2) the jury were further to believe, as juries often will, that awards are taxable. That such an interpretation is highly likely is illustrated by the instruction given in this case. The directive "to fix the amount of money which will reasonably and fairly compensate the survivors for their pecuniary loss" (A83) could be construed as requiring that the jury ensure that claimants receive such amount of disposable—*i.e.*, "after-tax"—income as will fully compensate them. The proposed instruction is needed to avoid the possibility that the jury, because of ambiguity in the instruction and jury misinformation as to whether the award is taxable, would grossly overcompensate the plaintiff in violation of applicable law. It is for these reasons that every court of appeals that has considered the matter has rejected the Illinois

[28]Similarly, respondent's claim that the proposed instruction is not a correct statement of the law because it does not state that interest earned on the award is taxable and that it thus could lead a jury to reduce the award by the "tax savings" on interest (Respondent's Brief, at 30–31)—in addition to being wholly unrealistic—also ignores that all the instruction says is that no amount should be *added* to the *award* by reason of taxes payable on *it*. Of course, if a FELA plaintiff were genuinely concerned that the proposed instruction could prejudice him—which he should not be—he could seek an instruction concerning the taxability of the interest.

position that the nontaxability instruction is prohibited, and a number of courts have required that it be given in all cases. *See* Petitioner's Brief at 35 n.28 & 36.

B. The Refusal To Give The Nontaxability Instruction Here Constituted Reversible Error.

Respondent offers no substantial response to petitioner's claim that the failure to give the instruction here represented reversible error. Her brief does not seriously dispute that, in our tax-conscious world, juries are likely to assume that damages awards—like nearly every other receipt of cash—is taxable to the recipient. Respondent's sole argument to the contrary is the fact that I.R.S. Publication 17, Your Federal Income Tax, 1979 Edition, states at the bottom of the third column of page 71[29] (of a 192-page volume) that damages received for injury or sickness are exempt from tax. (Respondent's Brief, at 11) This claim of respondent's is no more an answer to petitioner's submission than would be an argument that all jurors are aware of the exemption because it appears in the Internal Revenue Code.

Nor does respondent deny that the most likely explanation for the fact that the jury here awarded respondent $775,000—when her own expert testified the pecuniary loss was $302,000—is that the jury assumed that the award would be taxed and interpreted the court's instruction as requiring it to inflate the award by the amount of an imagined tax.

Respondent argues, in the alternative to her main argument (Respondent's Brief, at 34–35), that the nontaxability instruction should be required prospectively only. While this is the *least* that should be required—the benefits of this instruction being so clear and the burdens so minimal—there was in the present case every basis for believing that

[29]Respondent's statement that this appears on p. 11 is in error.

the failure to give the instruction misled the jury into doubling the amount of the award. Accordingly, the case at bar is far clearer than *Michigan Central R.R. Co.* v. *Vreeland*, 227 U.S. 59, 72 (1913), where a similar ambiguity in the instructions was held to require reversal of the judgment.

CONCLUSION

For the foregoing reasons, as well as those stated in Petitioner's Brief, the judgment of the Illinois Appellate Court, First District, First Division, should be reversed.

Respectfully submitted,

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APPENDIX

26 U.S.C. §104(a), Int. Rev. Code of 1954, §104(a).

(a) In general.—Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, gross income does not include--

(1) amounts received under workmen's compensation acts as compensation for personal injuries or sickness;

(2) the amount of any damages received (whether by suit or agreement) on account of personal injuries or sickness;

(3) amounts received through accident or health insurance for personal injuries or sickness (other than amounts received by an employee, to the extent such amounts (A) are attributable to contributions by the employer which were not includible in the gross income of the employee, or (B) are paid by the employer); and

(4) amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country or in the Coast and Geodetic Survey or the Public Health Service, or as a disability annuity payable under the provisions of section 831 of the Foreign Service Act of 1946, as amended (22 U.S.C. 1081; 60 Stat. 1021).

For purposes of paragraph (3), in the case of an individual who is, or has been, an employee within the meaning of section 401(c) (1) (relating to self-employed individuals), contributions made on behalf of such individual while he was such an employee to a trust described in section 401(a) which is exempt from tax under section 501(a), or under a plan described in section 403(a), shall, to the extent allowed as deductions under section 404, be treated as contributions by the employer which were not includible in the gross income of the employee.